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No. 173

In the Supreme Court of the United States

OCTOBER TERM, 1935

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SAMUEL A. SALVAGE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

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OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 28–32) is unreported. The opinion of the Circuit Court of Appeals (R. 74–78) is reported in 76 F. (2d) 112.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 25, 1935. (R. 78.) The petition for a writ of certiorari was filed June 25, 1935, and granted October 14, 1935. The jurisdiction of this Court is invoked under Section 240(a) of the

Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Where an employee purchases stock from his employer at an amount substantially less than its fair market value and fails to report the difference as income in his return for the year in which the purchase was made, is he, in computing the profit from the redemption of the stock in a later year, estopped to claim that the basis for measuring the gain from the redemption is not the actual cost to him but the fair market value of the stock as of the date of its receipt?

STATUTES AND OTHER AUTHORITIES INVOLVED

The applicable statutes and other authorities involved will be found in the Appendix, *infra*, pp. 23–26.

STATEMENT

The following facts are taken from the stipulation of facts, the memorandum opinion of the Board of Tax Appeals, and the deposition of the taxpayer:

In December, 1922, the respondent, an officer and employee of the Viscose Company, owned 25 shares of stock of that Company which he had purchased in 1916 at a cost of $166.66⅔ a share. (R. 28.) On December 15, 1922, the stockholders and directors of the Viscose Company authorized it to increase its capital stock by 4,000 shares and the issuance of 1,500 of these shares to respondent at par ($100). (R. 46–50.)

On December 30, 1922, an agreement was made between the respondent and the Viscose Company which recited that the Company had sold 1,500 shares of its stock to the respondent at par, and provided, in part, as follows (R. 14, 15):

> 1. That Salvage does hereby agree to and with the Company that the said Company shall have the right to repurchase from him or his nominees, and he does hereby undertake, on behalf of himself, his heirs, executors, administrators and assigns, to procure for and deliver to the said Company for repurchase at par, the following proportions of the said 1,500 shares:
>
> At any time during the year 1923, five-sevenths;
>
> At any time during the year 1924, four-sevenths;
>
> At any time during the year 1925, three-sevenths;
>
> At any time during the year 1926, two-sevenths;
>
> At any time during the year 1927, one-seventh of the said 1,500 shares.
>
> 2. Salvage does further hereby agree to and with the Company that he will not at any time during his life in any part of the United States of America, except the States of Utah, Nevada, and New Mexico, Canada, the United Kingdom of Great Britain, or the Free State of Ireland, directly or indirectly, alone or in partnership, or as a Director or other Officer of a corporate body or as an Agent or otherwise howsoever, carry on or

> be engaged in any trade, business, or occupation for the manufacture or production of artificial silk, rayon, or Viscose, or of any material goods, or articles from Viscose in any form, nor enter into the service of or, directly or indirectly, assist or act for any person, firm, or corporation, in such trade or business or manufacturing or contemplating the manufacture of artificial silk or rayon, without the express written consent of the said Company. .

The option above referred to was never exercised. (R. 29.)

On the same date that this agreement was made with the Viscose Company (hereinafter referred to as the old Company), the American Viscose Corporation (hereinafter called the new Company) was incorporated in Delaware and issued four shares of its preferred and five shares of its common stock in exchange for each share of stock of the old Company. (R. 12.)

On the same day (December 30, 1922), the respondent exchanged his 1,525 shares of stock of the old Company which had cost him $154,166.66 [1] for 6,100 shares of preferred stock and 7,625 shares of common stock of the new Company. The preferred shares were callable at $110 per share and were redeemed at that figure in 1929, the respondent receiving $671,000 upon such redemption. (R. 29.)

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[1] 25 shares purchased in 1916 for $4,166.66 and 1,500 shares purchased December 30, 1922, for $150,000, total $154,166.66.

In filing his income-tax return for 1929 the respondent reported as capital net gain from the redemption of the preferred stock the difference between $671,000, the amount received for it, and $154,166.66, the entire cost of his 1,525 shares of old Company stock exchanged for preferred and common stock of the new Company. (R. 29.)

The Commissioner determined a deficiency of $12,005.38 by resolving that 37.778 percent of the cost of the old stock should be apportioned to the new preferred stock, and 62.222 percent of such cost to the new common stock. This apportionment was arrived at by finding that the preferred and common stock of the new Company had values of $110 and $144.94 per share, respectively, as of the date of exchange. (R. 13, 20, 29.) Such apportionment was in accord with the allocation made by a firm of certified public accountants employed by the respondent for the purpose of arriving at the capital net gain. (R. 17, 22.) In this manner the Commissioner determined that the total cost to the respondent of 6,100 shares of the preferred stock of the new Company was $58,123.47 (37.778 percent of $154,166.66), and that the difference between that amount and $671,000, or $612,876.52, was the correct amount of capital net gain. (R. 29.)

Before the Board the respondent claimed that it was not practicable to determine the fair market value of the preferred and common stock as of December 30, 1922, that no apportionment of the

cost of the old stock between the new preferred and new common should be made, and that the entire cost of the old stock should be used as a basis for determining the capital net gain resulting from redemption of the preferred shares in 1929. In addition, he claimed a refund of $63,750 on the ground that the proper basis for valuation of the stock received in exchange for the 1,500 old shares was not the cost of such 1,500 shares ($100 per share), but their fair market value as of the date of their acquisition ($1,164.70 per share), his theory being that the difference between the cost and fair market value represented compensation for his services as president of the old and new Companies, and consideration for his covenant not to engage in a competing business. (R. 2–3, 29–30.)

The Board found that such difference was not compensation for services and that neither the respondent nor the company had so treated it for tax purposes. It held that the basis for determining the capital net gain resulting from redemption of the preferred shares in 1929 was the cost of the old stock and not its fair market value, and that the cost was properly apportioned by the Commissioner between the preferred and the common shares. (R. 29, 31–32.)

The court below agreed in holding that the difference between the cost and market value of the old stock was not compensation for services in 1922; but it held that such difference was income realized

in 1922 as consideration for respondent's promise not to engage in a competing business, and that respondent was not estopped to claim that the basis for determining the capital net gain realized from redemption of the preferred shares in 1929 was the fair market value of the old stock when acquired in 1922, notwithstanding the difference between the cost and the fair market value was not reported by him as income for that year or any other year. It therefore held that the basis for determining the capital net gain realized from redemption of the preferred shares in 1929 was the fair market value of the old stock when acquired in 1922 and not cost; but that only two-sevenths of the 1,500 shares then had a market value of $1,164.70 per share, or a total value of $499,157.14, the remaining five-sevenths having then a market value of $100 per share, or a total value of $107,142.86, by reason of the option of the corporation to repurchase, so that the aggregate market value of the 1,500 shares when acquired in 1922 was $606,300, though the respondent paid for them only $150,000, the difference being the consideration for his agreement not to compete. (R. 76.)

The court further held that the cost base of the old shares ($4,166.66 for the 25 shares and $606,300 for the 1,500 shares) should be apportioned according to the method used by the Commissioner. This gives a cost base of $230,662.09 (37.778 percent) for the preferred stock and of $379,844.57 (62.222 per-

cent) for the common. Since such cost base for the preferred stock was in excess of the cost base originally reported by the respondent, the court held that there was no deficiency and directed the Board to determine the amount of the refund due. (R. 77, 78.)

SPECIFICATION OF ERROR TO BE URGED

The Circuit Court of Appeals erred:

In failing to hold that the respondent was estopped to claim that the basis for measuring the gain from the redemption of his new stock in 1929 was the fair market value of the old stock when acquired in 1922, by his failure to report the difference between the cost and fair market value as income for 1922.

SUMMARY OF ARGUMENT

A litigant may not found a claim on his own omissions or wrongful acts. The respondent, having purchased from his employer on December 30, 1922, for $100 per share and a covenant not to engage in competing business, stock having a market value on that date of $1,164.70 per share, and having failed to report the difference as income in his income-tax return for that year, should not now, after the statute of limitations for the 1922 income has expired, be permitted to contend that the difference between the market price and the cash price he paid was 1922 income and thus profit from his own wrongdoing at the expense of the Government.

The controlling factor in cases presented to the Board of Tax Appeals is the correctness of the result reached by the Commissioner and where all of the facts were before the Board the court may consider points which were not raised before the Board or passed upon by it.

ARGUMENT

The respondent on December 30, 1922, purchased stock from his employer, the Viscose Company, for $100 per share, which had a fair market value on that date of $1,164.70 per share. He now admits that he did not report the difference as income in his income-tax return for 1922 (R. 40–41); that he did not put anything in his return for the year 1922 or make any statement to the effect that he had received compensation (R. 41), and that he did not regard the difference between the cost and the market value as compensation. He also admits that he reported nothing but cash received in any year (R. 43) and that when he filed his 1922 return he did not consider that he had received any property of value which was not included in the return (R. 46).[2] In 1929 part of the stock was redeemed

[2] Other evidence in the record also reveals clearly that the respondent did not consider, either in 1922 when he purchased the stock or in 1929 when the preferred stock was redeemed, that the difference between the purchase price and the fair market value in 1922 was income to him. In filing his income-tax return for 1929 he reported as a gain from the redemption of the preferred stock the difference between $671,000, the amount received, and $154,166.66, the entire cost

and he now contends that the basis for measuring his profits on the redemption of the stock should be the market price at the time he purchased it, and not the lesser cost of it to him.

Section 213 (a) of the Revenue Act of 1921, *infra,* defines gross income as including gains, profits, and income derived from salaries, wages, or compensation for personal services of whatever kind and in whatever form paid, and provides for including such items in gross income for the taxable year in which received. Section 223 (a) *infra,* provides that every individual having a taxable net income shall make a return under oath "stating specifically the items of his gross income."

Treasury Decision 3435, II–1 Cumulative Bulletin 50, *infra,* promulgated February 7, 1923, provides that where property is sold by an employer to an employee for an amount substantially less than its fair market value, the difference between the cost and the fair market value shall be included in gross income by the employee. It also provides that in computing the gain or loss from

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of all the shares of the old company. It was not until 1932, when he filed a claim for refund (R. 69, 70), that he first made the claim that the difference between the cost of the stock and the fair market value in 1922 represented additional compensation to him as an officer of the Viscose Company. When he filed his petition with the Board on September 10, 1932, he then for the first time claimed that he received the difference as additional compensation from the Viscose Company and as a consideration for entering into an agreement not to compete.

a subsequent sale of the property its cost shall be deemed to be its fair market value at the date of acquisition.[3]

The plain facts in this case are that the respondent, having escaped paying taxes on the income received through the purchase of the stock, now seeks to take advantage of his own wrong and urges that he should be allowed to compute his profit on the redemption of the preferred stock in accordance with the method outlined in Treasury Decision 3435, even though he failed to report the income as provided therein.

It was the respondent's duty to report the income in his 1922 return, which he failed to do. He now asserts that what he received was income and contends that his profits should be measured on that theory. His failure to report the income constituted, in effect, a representation to the Commissioner that no income had been received, and that representation was relied upon by the Commissioner to the Government's detriment. The re-

[3] *Commissioner* v. *Van Vorst*, 59 F. (2d) 677 (C. C. A. 9th), and *Taplin* v. *Commissioner*, 41 F. (2d) 454 (C. C. A. 6th), hold that Treasury Decision 3435 does not apply to *every* case where property is sold by a corporation to its stockholders at a price substantially less than its fair market value. It was mentioned but not specifically approved or disapproved in *Robinson* v. *Commissioner*, 59 F. (2d) 1008 (C. C. A. 6th). In *Larkin et al.* v. *United States*, 78 F. (2d) 951 (C. C. A. 8th), it was held that it was prospective and not retroactive in its operation and therefore not applicable to taxable years ending prior to February 7, 1923, the date of its issuance.

spondent now, after the statute of limitations has expired, attempts to reverse the position taken by him in 1922. The existence of these elements is all that is required to establish equitable estoppel. *Stone* v. *Bank of Commerce,* 174 U. S. 412; *Kirk* v. *Hamilton,* 102 U. S. 68; *Dickerson* v. *Colgrove,* 100 U. S. 578; *Oklahoma* v. *Texas,* 268 U. S. 252. Regardless, however, of any contentions which the respondent may make to the effect that this case does not meet with the strict textbook or dictionary definition of estoppel, the facts herein clearly show that the respondent is founding his claim on his own omission, concealment, or wrongdoing. The principle that a litigant may not found his claim on his own inequity or wrong was forcefully enunciated by this Court in the case of *Stearns Company* v. *United States,* 291 U. S. 54, wherein the Court said (p. 61):

> Sometimes the resulting disability has been characterized as an estoppel, sometimes as a waiver. The label counts for little. Enough for present purposes that the disability has its roots in a principle more nearly ultimate than either waiver or estoppel, the principle that no one shall be permitted to found any claim upon his own inequity or take advantage of his own wrong. *Imperator Realty Co.* v. *Tull, supra.* A suit may not be built on an omission induced by him who sues.

Two cases in which the facts were almost identical with the facts in the case at bar have been

decided by the Circuit Courts of Appeals for the Tenth and Eighth Circuits, respectively.

In *Bothwell* v. *Commissioner,* 77 F. (2d) 35 (C. C. A. 10th), the taxpayers in 1927 purchased stock of a corporation, of which they were officers, for a price far below its fair market value. In 1928 they sold such stock and contended that the profit on the sale was the difference between the fair market value of the stock on the date they acquired it in 1927 and the selling price in 1928. They claimed that the difference between the price at which they purchased it and its fair market value was compensation for personal services rendered the corporation, but they had not reported such difference in their income-tax returns for the year 1927, and at the time they first made such contention the statute of limitations had expired for that year. In holding that they were estopped to claim the fair market value in 1927 as the basis for measuring the profit on the sale, the court said (p. 37):

> By failing to report such income, each in effect declared that no such income had been received by him. *Crane* v. *Commissioner* (C. C. A. 1) 68 F. (2d) 640, 641. Furthermore, up to the time the amended petitions were filed, each had asserted that the income received by him was capital gain rather than compensation for services. At the time the amended petitions were filed the statute of limitation had run as to the 1927 taxes.

* * * * *

> Darby and Bothwell each having declared in 1927 that no part of the value of the stock was compensation for services, and having continuously asserted from 1928 until after the statute of limitation had run against taxes for 1927, that the whole of the profit derived from the sale of such stock was capital gain, they are now precluded from asserting that a portion of the value of such stock was compensation for services. They are barred from so doing by their wrongful acts and omissions.

In *Larkin et al.* v. *United States,* 78 F. (2d) 951 (C. C. A. 8th), which was decided on August 15, 1935, subsequent to the case at bar, the taxpayers who had purchased from their employer at $100 per share stock having a fair market value of $250 per share subsequently on the sale of that stock, attempted to show a loss by basing the cost on the market value. The court held that the failure of the taxpayers to report the difference in their income-tax returns for the year in which the stock was purchased estopped them from maintaining the suit. At page 954 the court said:

> We think the taxpayers are precluded by their conduct, as shown in their complaints, including exhibits, from maintaining the present suits.

A case similar in all respects to the instant case is that of *Crane* v. *Commissioner,* 68 F. (2d) 640 (C. C. A. 1st), where a taxpayer in 1920 leased his property for a term of years and, in accordance

with the terms of the lease, improvements costing $95,000 were made by the lessee, which were to revert to the lessor upon the termination of the lease. No part of the cost of the improvements was reported as income by the lessor. In 1927 he sold the property, subject to the lease, and in filing his income-tax return for that year, computed the profit from the sale by adding to the March 1, 1913, value the depreciated cost of the improvements made by the lessee. The Commissioner recomputed the profit without making any allowance for the depreciated value of the improvements since they had not been reported as income in his return for the year 1920. The Circuit Court of Appeals in affirming the Board and the Commissioner said (p. 641):

> This obligation to report and pay a tax was never performed, and cannot now be enforced against the petitioner, because it is barred by the statute of limitations. The petitioner urges that he is entitled to the benefit of the statute of limitations, and so he is. The obligation can no longer be enforced. But the failure, however innocent, to report this income, consituted in effect a statement that no such income was rereceived, and the government, in reliance thereon, failed to receive the amount of any such tax as might have resulted if the petitioner's returns had been accurate. The statutes and regulation should not be construed to entitle a taxpayer to the benefit

> of an expenditure made by his lessee, when the taxpayer has failed to report or to pay a tax in the appropriate year or years upon the income received by virtue of the lessee's expenditure.[4]

Other cases in which the doctrine of estoppel has been applied to taxpayers who failed to report income or who sought to change their position to the detriment of the Government are *Askin & Marine Co.* v. *Commissioner,* 66 F. (2d) 776 (C. C. A. 2d); *Haag* v. *Commissioner,* 59 F. (2d) 514 (C. C. A 7th); *Commissioner* v. *Moore,* 48 F. (2d) 526 (C. C. A. 10th); *Edward G. Swartz, Inc.* v. *Commissioner,* 69 F. (2d) 633 (C. C. A. 5th).[5]

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[4] The court below did not agree with the majority opinion in the above case but thought that the concurring opinion of Judge Morton was the sounder argument. Judge Morton repudiated the estoppel theory and based his concurring opinion on the theory that the taxpayer had elected in good faith to let his gain or loss ride along until the termination of the lease and that the sale of the property terminated the lease, and the gain thereupon became taxable as income. While the concurring opinion reaches the correct result, the conclusion is based upon the wrong premise, because a taxpayer may not elect the year in which income shall be taxed. The Revenue Acts, without exception, tax incomes to the recipient in the year in which it is actually received or accrued; and a taxpayer who is in receipt of income may not defer reporting it until a later year. *North American Oil* v. *Burnet,* 286 U. S. 417, 424; Section 213 (a) of the Revenue Act of 1921; and Article 51 of Regulations 62.

[5] See also *Wheelock* v. *Commissioner,* 77 F. (2d) 474 (C. C. A. 5th); *Commissioner* v. *Liberty Bank & Trust Co.,* 59 F. (2d) 320 (C. C. A. 6th); *Matern* v. *Commissioner,* 61 F. (2d) 663 (C. C. A. 9th); *Giant Furniture Co.* v. *United States,* 9

The court below, in holding that the respondent was not estopped to set up as a cost basis the market value of the old stock which he acquired in 1922, cited *United States* v. *S. F. Scott & Sons,* 69 F. (2d) 728 (C. C. A. 1st), and *Helvering* v. *Brooklyn City R. Co.,* 72 F. (2d) 274 (C. C. A. 2d). Both cases are, however, quite different from the present one. In the *Scott* case, *supra,* a corporation paid a tax which the Commissioner had assessed against it, but which should have been assessed against an individual. The court found that the corporation did nothing and said nothing which misled the Government as to the facts, and that "the error originated in the misapprehension of the Commissioner as to the law applying to the assessment of the tax in question." Of course, such a case is not one calling for the application of the doctrine of estoppel because the Commissioner was not misled.

In *Helvering* v. *Brooklyn City R. Co., supra,* the question involved was whether the taxpayer was estopped to contend that a return for the calendar year 1921 should have been a return for a fiscal

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F. Supp. 585 (C. Cls.); *Adler* v. *Commissioner*, 77 F. (2d) 733 (C. C. A. 5th); *Continental Products Co.* v. *Commissioner*, 66 F. (2d) 434 (C. C. A. 1st); *Moran* v. *Commissioner*, 67 F. (2d) 601 (C. C. A. 1st); *Putnam Nat. Bank* v. *Commissioner*, 50 F. (2d) 158 (C. C. A. 5th); *Naumkeag Steam Cotton Co.* v. *United States*, 2 F. Supp. 126 (C. Cls.), certiorari denied, 289 U. S. 749; *Mahoning Investment Co.* v. *United States*, 3 F. Supp. 622 (C. Cls.), certiorari denied, 291 U. S. 675; *Hartwell Mills* v. *Rose*, 61 F. (2d) 441 (C. C. A. 5th).

year. The court held that there was no estoppel. But in that case a cursory examination of the taxpayer's books would have disclosed the fact that they were kept on a fiscal year basis, and the statute required that the return be made on the same basis as the books. It was not shown that the tax for earlier years would have been greater if the returns had been properly filed, and in the only year in which it might have been said that the Government was injured it was not shown whether the question was raised so late as to prevent a correction.

The same court (the court below), in the earlier case of *Askin & Marine Co.* v. *Commissioner, supra,* held that where a taxpayer had charged off certain debts as worthless in one year and subsequently collected them, he would not be heard to say that they were not worthless in that year for the purpose of eliminating from his return the income represented by the collections in a later year.

If the Court should concur in the opinion of the court below, that the respondent is not estopped, nevertheless, he should not be entitled to a refund of taxes already paid. The situation then presented in the instant case would not be materially different from that involved in *Bull* v. *United States,* 295 U. S. 247. There the Commissioner had treated an item as capital for estate-tax purposes and also as income for income-tax purposes. This Court held that the item was properly taxable as

income and that it did not form a part of the gross estate. However, the statute of limitations had run against the filing of a suit for recovery of the estate tax, but it was held that the claim of the Commissioner for additional income taxes was in the nature of a suit by the United States, and as the claim arose out of the same transaction, the taxpayer was entitled to recoup the amount mistakenly collected as an estate tax. Since the income and profits involved in the present case arise from the same transaction, the Commissioner, under the authority of *Bull* v. *United States, supra,* should be entitled to a recoupment of the taxes which should have been paid for the year 1922. As was said in that case (p. 262):

> Such a defense is never barred by the statute of limitations so long as the main action itself is timely.

The issue of estoppel was first raised in the court below on reargument, but no question was raised either by the respondent or by the court as to the failure of the pleadings to present the issue or a plea of estoppel. At common law it was not necessary to plead estoppel *in pais, Feinberg* v. *Allen,* 208 N. Y. 215; *Boone* v. *Citizens Bank & Trust Co.,* 154 Tenn. 241; *Shelton* v. *Southern Railway Co.,* 255 Fed. 182, Bigelow on Estoppel, 5th Ed. p. 699,[6]

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[6] That is still the law in some jurisdictions (see *Shutter Bar Co.* v. *Zimmerman,* 110 Md. 313; *Feinberg* v. *Allen,*

and it need not be pleaded in proceedings which do not contemplate formal technical pleading. *Gilcrest Co.* v. *Des Moines,* 157 Iowa 525, 137 N. W. 1072. Several decisions indicate that the Board of Tax Appeals, as an administrative body, is not bound by strict rules of pleading and that the Circuit Court of Appeals had authority to consider the estoppel issue. In *Board of Tax Appeals* v. *United States ex rel. Shults Bread Co.,* 37 F. (2d) 442, certiorari denied, 281 U. S. 731, the Court of Appeals for the District of Columbia held that mandamus should not issue to compel the Board to enter judgment by default for the taxpayer, when the Commissioner had not filed his answer in time. See also *Greengard* v. *Commissioner,* 29 F. (2d) 502 (C. C. A. 7th). In *Hanby* v. *Commissioner,* 67 F. (2d) 125 (C. C. A. 4th), it was held that a question of fraud was properly put in issue although not affirmatively alleged in the Commissioner's answer, where it was obvious to petitioner that fraudulent conduct on his part formed the basis of the

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supra; Intertype Corp. v. *Pulver,* 2 F. Supp. 4 (S. D. Fla.), affirmed, 65 F. (2d) 419 (C. C. A. 5th), certiorari denied, 290 U. S. 660; *Bemis* v. *Pacific Coast Casualty Co.,* 125 Minn. 54), while in others it must be pleaded if there is opportunity. *Laughinghouse* v. *Insurance Co.,* 200 N. C. 434; *Hall & Farley* v. *Henderson,* 126 Ala. 449; *Mabury* v. *Louisville & J. Ferry Co.* 60 Fed. 645 (C. C. A. 7th); *Promis* v. *Duke,* 208 Cal. 420; *Walker* v. *Fireman's Fund Ins. Co.,* 114 Ore. 545. Each State has its own rule, influenced to a considerable extent by its statutes concerning pleading.

Commissioner's determination. Moreover, both the Board and the Circuit Court of Appeals considered the question of estoppel in *Crane* v. *Commissioner, supra,* although the issue was not raised in the pleadings. In *Helvering* v. *General Utilities & Operating Co.,* 74 F. (2d) 972 (C. C. A. 4th), it was held that the controlling factor in this class of cases is the correctness of the result reached by the Commissioner and that points not raised before the Board may be considered by the court. At page 975 the court said:

> As to the second point raised by the petitioner, it is contended on behalf of the respondent that this point, not having been raised before the Board, cannot now be urged before us for the first time. We cannot agree with this conclusion. The correctness of the result reached by the Commissioner of Internal Revenue in determining the deficiency is the controlling factor, and not the method by which it was determined nor the reasons given for the determination. *Hughes* v. *Commissioner* (C. C.) 38 F. (2d) 755; *Hurwitz* v. *Commissioner* (C. C. A.) 45 F. (2d) 780; *Helvering* v. *Gregory* (C. C. A.) 69 F. (2d) 809.

It is clear that the question was properly before the court.

CONCLUSION

It is therefore respectfully submitted that the decision of the court below should be reversed.

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NOVEMBER 1935.

APPENDIX

Revenue Act of 1921, c. 136, 42 Stat. 227, 237, 250:

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items (except as provided in subdivision (e) of section 201) shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; * * *.

SEC. 223. (a) That the following individuals shall each make under oath a return stating specifically the items of his gross

income and the deductions and credits allowed under this title—

(1) Every individual having a net income for the taxable year of $1,000 or over, if single, or if married and not living with husband or wife;

(2) Every individual having a net income for the taxable year of $2,000 or over, if married and living with husband or wife; and

(3) Every individual having a gross income for the taxable year of $5,000 or over, regardless of the amount of his net income.

* * * * *

Revenue Act of 1928, c. 852, 45 Stat. 791, 816, 818:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * *

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at

least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

* * * * *

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(6) TAX-FREE EXCHANGES GENERALLY.—If the property was acquired upon an exchange described in section 112 (b) to (e), inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112 (b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for

the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it;

* * * * *

Treasury Decision 3435, II-1 Cumulative Bulletin 50:

INCOME TAX—SALE OF PROPERTY AT AN AMOUNT SUBSTANTIALLY LESS THAN ITS FAIR MARKET VALUE

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF
INTERNAL REVENUE,
Washington, D. C.

To collectors of internal revenue and others concerned:

Where property is sold by a corporation to a shareholder or member, or by an employer to an employee, for an amount substantially less than its fair market value, such shareholder or member of the corporation or such employee shall include in gross income the difference between the amount paid for the property and the amount of its fair market value. In computing the gain or loss from the subsequent sale of such property its cost shall be deemed to be its fair market value at the date of acquisition.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 7, 1923.

A. W. MELLON,
Secretary of the Treasury.

U. S. GOVERNMENT PRINTING OFFICE: 1923